The Virginia Plan

Thank you Mr. Chairman. Before you is a chart of what Bob Black and I have come to call the Virginia Plan. Now Bob has lived forty some years in Virginia, and as Terry Sanford will tell you I've only lived there six. So the plan is thirty parts Bob's, only about six parts mine. Further, all of the experience and wisdom behind the plan are his. All I contributed was the picture. Still, he asked me to go first.

In my confirmation hearings I said that we face two challenges in setting monetary policy today. In the short run, we must assure that the system has enough liquidity to assure a resumption of sustained economic growth. In the long run, we must move toward eventually achieving price stability. What I find particularly attractive about the Virginia Plan is that it meets both policy objectives simultaneously.

But this plan not only meets the pragmatic demands of policy, it also makes good intellectual sense. We all differ on the extent to which money matters. But if it does matter, the way in which it matters is best described by the Virginia Plan. Let us try an old Socratic test. Suppose we agreed that money matters and that the right amount of money growth was 4 percent per year. Now, I ask the question: How much more money should we have two years from now than we have today?

There are two possible answers. Answer A is 8 percent, or as close to that as is practicable. Answer B is a bit more complicated: it is between 2 and 6 percent more than however much money we end up with 12 months from now.

Now, you could say that I'm being unfair. It's more complicated than that, and it is. But the way it is more complicated has to do with the practical necessities of policy implementation, and not with theoretical elegance. While the Virginia Plan is not Milton Friedman's famed computer, the one which would put us all on the unemployment line, it does at least capture the essence of Friedman's idea: that in the long run, a stable rate of growth of the money supply is the best policy.

Specifically, we suggest that the FOMC set a 4 percent money growth target for 1992. The target range for 1992 would start at the upper and lower ends of the 1991 target range. The central tendency within the target range presumes that monetary policy eventually is successful in meeting the stated objective of this Committee in late 1991: to move money growth back toward the midpoint of the 1991 target range. We do not necessarily believe that we must move back to that midpoint in a single year. But it does recognize, as the Bluebook makes clear, that last year's undershoot was not deliberate but inadvertent.

From a policy perspective, this meets both our short-run objective of assuring adequate liquidity to sustain an economic expansion and our long-run objective of slowing money growth so as to achieve price stability. Meeting these twin objectives is probably impossible under the "cone" approach.

But, the most important reason for adopting the Virginia plan is not a short-run need for adequate money growth or our ability to send a long-term signal. It goes to the root of macroeconomic policy. Last night, after listening to the comments from the different districts, I concluded that we were uncertain about the forecast because so much of our economic policy is now becoming pro-cyclical. The normal correction mechanisms of the market which cause the business cycle to move from contraction to expansion are being exacerbated by pro-cyclical policies.

In the fiscal arena, according to the staff estimates, we are witnessing a fiscal contraction in the first year of a recovery for the first time in memory. Our recently enacted banking laws cause a contraction of loans in the midst of asset price declines, and will, on the up side, cause an equal expansion of loan capacity in the midst of asset price increases.

The best reason to adopt the Virginia Plan is that it is deliberately stabilizing, not destabilizing. Furthermore, it makes the stabilizing intent of this Board plain for all to see. In an era in which the public is concerned about the wisdom of those who control our fiscal policy, a stated intention by this Board that we will impose the discipline on ourselves to be countercyclical can only help to improve confidence.

So, aside from the theoretical niceties of the system, I think there are sound practical reasons to adopt the Virginia Plan. We can set short-term money growth targets this year which are consistent with sustained growth. We can send a signal to the markets that we care about our long-term goal of price stability by cutting our money growth target. And, we can announce that this Board intends to be a force for stable policy.

At least in Virginia, killing three birds with one stone ain't bad. I now turn to my fellow Virginian to articulate far better than I have here, why we should adopt this approach.

The Virginia Plan